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Business Growth: Bespoke Strategists Lead the Way

The last five years has been one of significant evolution for the pharmaceutical industry.

In a context of significant industry restructuring, cost-cutting and patent expiries, 26 of the world's top pharmaceutical companies have managed to grow their top-line revenues by more than 50% over the last 5 years. Some of the companies have achieved this growth highly profitably, some have sacrificed profits to grow top-line revenue. Some have invested heavily in R&D, some have chosen to avoid heavy R&D investment. So what can we learn from their diverse successes? In this paper we identify the 26 top-growing companies and classify them into three segments to illustrate the contrasting dominant strategic philosophies that have been applied to achieve business growth. We explore the success stories of selected companies within each of the three segments, and then conclude by examining the common theme that we believe has had a key role in driving business growth: that of 'bespoke strategy'.

Introduction

The last five years has been one of significant evolution for the pharmaceutical industry. In terms of new drug product approvals, the trend is upwards in terms of both number and quality, yet the largest companies have been ruthlessly cost-cutting and reducing investment in both commercial and R&D infrastructure. Furthermore the cost of making

For the future, additional stakeholder pressure to remain innovative and launch new products could be driving these companies to maintain high investment in R&D, raising concerns about the sustainability of this business model. When considering profitability (measured as EBIT as a percentage of revenue in 2013) the group is varied, possibly a consequence of the scale and/or stage of the company. Moreover while almost all of the companies completed acquisition deals over the past five years, investment in such deals totalled less than the 2013 revenue. This is a relatively small investment and emphasises that R&D is still a strong driver for growth for this group with a focus on making targeted acquisitions.

Transitioning from the US Biotech model to more a established Pharma Company

With scale and maturity and the need to continuously create new products and manage the lifecycles of existing products, we believe that the Breakthrough group will inevitably transition over time into either Big Pharma or Build companies or both. Meanwhile the commitment to R&D is impressive. For example despite rapidly bringing five products to the market (four in-house), Biomarin continues to invest up to 65% of revenues in R&D with a respectful revenue growth of 85%. By contrast Alexion's high revenue growth relates solely to one product, Soliris, which is marketed for two ultra rare diseases. Its clinical pipeline is dominated by Soliris label expansion and LCM studies and has a low R&D spend relative to the group – more like a normal pharma company – but is this sufficient for future sustainability and growth? Finally Gilead has built its business through a mixture of in-house innovation in infectious diseases (HIV/AIDs) and targeted acquisitions, more recently moving into oncology. It is now transitioning into Breakthrough company to more of a Build company, achieving a steady R&D spend as a percentage of revenue; 19% in 2013 compared to 79% in 2001.

Chasing breakthrough innovation leads to more creative investment

Another example of how the Breakthrough companies have pursued growth is through their eagerness to accelerate drug development. Both Regeneron, with its collaborate Sanofi, and Gilead have bought FDA priority review vouchers to fast-track regulatory reviews of late-stage assets. The former bought a voucher from Biomarin for $67.5m[iii] in July 2014 while the latter paid $125m[iv] to Knight Therapeutics in November 2014. The voucher entitles the holder a regulatory short cut where the FDA completes a six-month review of a new drug application.

Buy: An acquisitive approach to growth

Acquisition is clearly the key driver for this segment of companies; typically these companies made low investments in R&D (less than 10% of revenue) whilst achieving revenue growth of greater than 100% during the past five years. This highly acquisitive approach is demonstrated by a significant investment in deals and not only by the number of the deals concluded (typically more than four deals made in the last five years). Valeant, Actavis and Endo Pharma have completed 28 acquisition deals between them and invested more than double their 2013 revenue into these deals between 2008-2013. Such significant investment is now reflected in the long-term debt that these particular companies have accumulated; taking long-term debt as a percentage of revenue (2013) gives 172%, 62% and 48% for Valeant, Endo and Actavis respectively. Predictably, the three companies above have not performed positively with respect to profitability, which ranges between -5% to -15%. These companies have achieved high revenue growth in the short-term through the addition of commercial portfolios but the key question is whether this growth can continue mid- to long-term?

Generic players are building R&D credibility in speciality pharma

This segment also features a number of growing generic players that are building a presence in speciality pharma, such as Lupin and Sun Pharma. Teva can also be classified in this category. All three of these companies have pursued growth from generics businesses while moving into speciality pharma through acquisitions. Moreover, Teva states that it "pursues robust organic growth" applying its R&D capabilities in the generics/OTC field into NME. For these particular companies, a gradual move into specialty pharma through this route allows them to build credibility in R&D while simultaneously continue to be profitable.

Jazz Pharma: the top grower of our sample

The largest revenue growth amongst the top 26 pharma growth companies over the last five years was achieved by Jazz Pharma, which represents a unique example of growth within this segment. Incorporated in 2003, Jazz now sells just two main products, Xyrem and Luvox CR, for narcolepsy and obsessive-compulsive disorder respectively. Jazz has exploited the orphan disease status of the former drug, which was obtained through the acquisition of Orphan Medical in 2005, enabling it to increase prices. Astonishingly Jazz has raised the price of Xyrem at an annual average rate of nearly 40%[v]. Coupled to the fact that R&D spend decreased between 2008 and 2011 and now represents just 5% of revenues means that Jazz achieved a highly respectable profitability of 39% of revenues in 2013. The question, as with all the Buy companies, is what next? By seeking innovation from acquisitions, the risk is lack of availability or overpaying or both. With the notable outliers of Valeant and Actavis, the other Buy companies are transitioning in some way to sustain themselves and mitigate the risk of being acquired themselves. It will be interesting to see how they all evolve over the next five years, but we believe that they do not represent a model that more conventional pharmaceutical companies can follow easily.

Is R&D required for pharmaceutical business growth?

The Breakthrough companies show that growth is contingent on NME launches that require significant R&D investment – still with the possibility of growth and high returns albeit with high risk. We believe that such companies cannot survive indefinitely by investing such a huge proportion of revenues into R&D, so will evolve to become established pharmaceutical companies with levels of R&D investment that are much lower as a proportion of revenues, as has been more recently achieved by Gilead and Alexion.

In contrast the Buy companies have shown that embracing an acquisitive approach can lead to immediate revenue growth without the need to invest in R&D. However the long-term sustainability of this business model is also questionable as demonstrated by the fluctuating and sometimes negative profitability of these companies over time. In short, chasing after acquisitions is an expensive game and though at an industry level it may be an efficient way to accelerate (arguably necessary) cost-cutting, sustainably profitable business growth may be more elusive. Indeed, a relatively recent example of this reality is that following Allergan’s strong defence against a takeover, Valeant has visibly cooled off its buying spree in an effort to relieve its debt and increase internal R&D output.

These companies have achieved not only respectful revenue growth year-on-year but also remained consistently profitable.

So perhaps the most valuable lessons can be learned from the Build companies. These companies have achieved not only respectful revenue growth year-on-year but also remained consistently profitable. They have leveraged their strengths to accomplish their goals, albeit by following different paths.

Bespoke Strategy: The common thread

The Build companies have demonstrated that significant growth does not necessarily depend on the new NME launches of the Breakthrough companies or the major acquisitions of the Buy companies. There is therefore hope and inspiration for all pharmaceutical companies that cannot realistically expect many NMEs or acquisitions. And the common thread to the success of the Build companies is their smart and focused choices. For example, Shire recently announced that its current pipeline is estimated to generate sales of $3 billion by 2020[vi], a pipeline that was constructed from a number of targeted acquisitions during the past five years.

The common thread that we therefore believe has had a key role in driving business growth for the Build companies in particular (and the Breakthrough and Buy companies in a different way) is that of 'bespoke strategy'. Bespoke strategists focus on exploiting and evolving from the unique and distinctive capabilities that they each alone possess – whether these are related to customer/stakeholder relationships, science/technology skills or financial market relationships/skills. The successful growing companies typically have best-in-class capabilities in one of these areas, for example Build companies typically have excellent customer/physician relationships and networks in focused domains, Breakthrough companies often have incredible science in specific fields, and Buy companies typically know and work their investor community better than even the financial institutions. So each of the 26 top growing companies has successfully developed and executed bespoke strategies that exploit their relative competitive strengths while ensuring that they have access to the necessary capabilities for growth for all other areas. They are indeed inspiration for successful pharmaceutical companies world-wide.